Legislative Audit Division

State of Montana

Report to the Legislature

December 2005

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2005

Office of the Commissioner of Higher Education

This report contains two recommendations regarding compliance with state law. Major issues addressed in the report include:

- **Reimbursing the state's General Fund $756,060**
- **Accounting for federal indirect cost recoveries**

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

05-19

Help eliminate fraud, waste, and abuse in state government. Call the Fraud Hotline at 1-800-222-4446 statewide or 444-4446 in Helena.

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report, which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

MEMBERS OF THE LEGISLATIVE AUDIT COMMITTEE

Senator Joe Balyeat, Vice Chair
Senator John Brueggeman
Senator Jim Elliott
Senator Dan Harrington
Senator Lynda Moss
Senator Corey Stapleton

Representative Dee Brown
Representative Hal Jacobson
Representative Christine Kaufmann
Representative Scott Mendenhall
Representative John Musgrove, Chair
Representative Janna Taylor

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

December 2005

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Office of the Commissioner of Higher Education (OCHE) for the two fiscal years ended June 30, 2005. This report contains two recommendations where OCHE could improve compliance with state law. The written response to the audit recommendations is included at the end of the audit report.

We thank the commissioner and her staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Room 160, State Capitol Building PO Box 201705 Helena, MT 59620-1705
Phone (406) 444-3122 FAX (406) 444-9784 E-Mail lad@mt.gov

Legislative Audit Division

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 2005

Office of the Commissioner of Higher Education

Members of the audit staff involved in this audit were John Fine, Alexa O'Dell, Jeff Tamblyn, Lena Tamcke, and Amber Thorvilson.

Table of Contents

Elected, Appointed and Administrative Officials ii
Report Summary S-1

Introduction 1
Introduction 1
Background 1
Board of Regents of Higher Education 1
Office of the Commissioner of Higher Education 2
Prior Audit Recommendations 4

Findings & Recommendations 5
Federal Indirect Cost Recoveries 5
Accounting For Federal Indirect Cost Recoveries 5
Transfers of Excess Indirect Costs 7

Independent Auditor's Report & Office Financial Schedules A-1
Independent Auditor's Report A-3

Schedule of Changes in Fund Balances & Property
Held in Trust for the Fiscal Year Ended June 30, 2005 ..... A-5

Schedule of Changes in Fund Balances & Property
Held in Trust for the Fiscal Year Ended June 30, 2004 ..... A-6

Schedule of Total Revenues & Transfers-In
For the Fiscal Year Ended June 30, 2005 ..... A-7

Schedule of Total Revenues & Transfers-In
For the Fiscal Year Ended June 30, 2004 ..... A-8

Schedule of Total Expenditures & Transfers-Out
For the Fiscal Year Ended June 30, 2005 ..... A-9

Schedule of Total Expenditures & Transfers-Out
For the Fiscal Year Ended June 30, 2004 ..... A-10

Office of the Commissioner of Higher Education
Notes to the Financial Schedules A-11

Office Response B-1
Office of the Commissioner of Higher Education B-3

Elected, Appointed and Administrative Officials

Board of Regents of Higher Education

		Term Expires
John Mercer, Chair	Polson	Feb. 1, 2008
Mike Foster, Vice Chair	Billings	Feb. 1, 2011
Stephen M. Barrett	Bozeman	Feb. 1, 2012
Kala French, Student Regent	Kalispell	Dec. 31, 2005
Lynn Morrison-Hamilton	Havre	Feb. 1, 2006
Mark Semmens	Great Falls	Feb. 1, 2007
Lila Taylor	Busby	Feb. 1, 2010

Brian Schweitzer, Governor*

Linda McCulloch, Superintendent of Public Instruction*

*Ex officio member

Commissioner of Higher Education

Sheila M. Stearns, Ed. D	Commissioner of Higher Education
Roger Barber	Deputy Commissioner for Academic and Student Affairs
Mick Robinson	Associate Commissioner for Fiscal Affairs (September 2005)
Pam Joehler	Director of Accounting and Budgeting

For additional information concerning the Office of the Commissioner of Higher Education, contact Pam Joehler at:

46 North Last Chance Gulch
PO Box 203201
Helena, MT 59620-3201
(406) 444-0320
e-mail: pjoehler@oche.montana.edu

Office of the Commissioner of Higher Education

We performed a financial-compliance audit of the Office of the Commissioner of Higher Education (OCHE) for the two fiscal years ended June 30, 2005. The prior audit report contained three recommendations. OCHE implemented all three recommendations. The two recommendations in this report relate to compliance with state laws.

We issued an unqualified opinion on the financial schedules contained in this report. This means the reader may rely on the information presented in the financial schedules and the supporting information on the state's accounting system.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the commissioner's office:

A. Record indirect costs recovered from the federal awards to the appropriate fund and account, in accordance with state law.

B. Reimburse the state's General Fund for the $756,060 in indirect cost recoveries improperly recorded to the Federal Special Revenue Fund. 7

Office Response: Concur. See page B-4

Recommendation #2

We recommend the commissioner's office cease recording financial activity in university Designated Subfunds. 8

Office Response: Concur. See page B-4

Introduction

Introduction

We performed a financial-compliance audit of the Office of the Commissioner of Higher Education (OCHE) for the two fiscal years ended June 30, 2005. The objectives of our audit were to:

1. Determine OCHE and the Board of Regents' compliance with applicable state and federal laws and regulations.
2. Make recommendations for improvements in OCHE's management and internal controls.
3. Determine the implementation status of prior audit recommendations.
4. Determine if OCHE's financial schedules are fairly presented for the two fiscal years ended June 30, 2005.

The Montana Guaranteed Student Loan Program, which is part of OCHE, allows eligible students to receive guaranteed loans from lending institutions for post-secondary education. The program is audited annually by our office (#05-06 and #04-06). Recommendations identified during the course of those audits are included in this report.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations made in this report. Areas of concern deemed not to have significant effect on the successful operations of OCHE are not specifically included in the report, but have been discussed with management.

Background

Board of Regents of Higher Education

Article X of the Montana Constitution establishes the Board of Regents of Higher Education (board) to govern and control the Montana University System. The board has administrative and supervisory control of the units of the university system and general supervision of community colleges. The board consists of seven members appointed by the governor and confirmed by the Senate. The governor and the superintendent of public instruction are ex officio members of the board.

Introduction

Office of the Commissioner of Higher Education

As required by Article X of the Montana Constitution, the board appoints a Commissioner of Higher Education. The board prescribes the term and duties of the commissioner. The commissioner is responsible for providing leadership, technical assistance, and staff support to the board and the units of the university system. Duties of the commissioner include academic planning and curriculum review, budgetary planning and control, legal services, and labor negotiation policies and procedures. Total authorized full-time equivalent (FTE) staff for OCHE was 100.7 during the audit period. This includes 19.4 FTE funded by the General Fund for general administration and operations, 3.65 FTE funded by the Enterprise Fund for Montana University System (MUS) group health insurance and workers' compensation programs, and 77.65 FTE for federal grant operations, of which 49.2 FTE are for the Montana Guaranteed Student Loan Program.

OCHE was accounted for in 12 programs in fiscal year 2003-04 as shown on the financial schedule on page A-10. Fiscal year 2004-05 had one additional program, the MUS Workers' Compensation Program, as shown on the financial schedule on page A-9. This program existed in fiscal year 2003-04, but the activity was not recorded on the state's accounting system, as described in note 6 to the financial statements on page A-14. A brief discussion of the current programs follows:

Administration Program - provides general administration for all the duties of OCHE. This includes academic, student assistance, financial, and legal administration as well as labor relations and personnel administration.

Board of Regents Administration - consists of the costs associated with the operation of the board.

Student Assistance Program - consists of the Western Interstate Commission on Higher Education (WICHE) student exchange program; the Washington, Wyoming, Alaska, Montana, Idaho (WWAMI) cooperative medical program; the Leveraging

Educational Assistance Partnership (LEAP) program; the Perkins Loan Fund match program; state matching dollars for the federal Supplemental Education Opportunity Grant (SEOG); the Montana Work Study Program; the Montana Tuition Assistance Program (MTAP); and the Baker Grants.

Guaranteed Student Loan Program - processes loan applications, maintains records on student borrowers, warehouses records, collects loan payments and performs other duties related to the Federal Family Education Loan Program (FFELP).

MUS Group Insurance Program - accounts for all activity related to the Montana University System employee benefits program and flexible spending plan.

Work Force Development Program - supports vocational education at the secondary and post secondary level. The board is designated as the sole state agency for the federal Vocational Education - Basic Grants to States, formerly known as the Carl D. Perkins program. Amounts used at the secondary level are subgranted to the Office of Public Instruction.

Improving Teacher Quality (formerly called Dwight D. Eisenhower Mathematics & Science Education Act) - is a federal program that provides funds to upgrade the teaching skills of teachers in the mathematics and science disciplines. Grants are awarded to institutions of higher education within the state on a competitive basis.

Talent Search - is a federally funded program to provide career and financial aid counseling to selected students. It includes General Fund support for an American Indian/Minority Achievement Program. It also includes the federally funded Gaining Early Awareness and Readiness for Undergraduate Program (GEAR UP).

Introduction

Appropriation Distribution - accounts for the distribution of the state's General Fund and millage appropriations to the university units.

Community College Assistance - accounts for the distribution of the state's assistance to the three community colleges.

Agency Fund - accounts for the OCHE Wellness Program activity.

Tribal College Assistance Program - accounts for the distribution of the state's assistance to the tribal colleges.

MUS Workers Compensation Program - accounts for all activity related to the Montana University System's self-funded workers' compensation program.

Prior Audit Recommendations

We performed the audit of the Office of the Commissioner of Higher Education (OCHE) for the two fiscal years ended June 30, 2003. The 2003 report contained three recommendations. OCHE implemented all three recommendations. However, one prior audit recommendation dealt with OCHE's use of Retirement Cost Revolving Accounts accounted for in a university Designated Subfund, as allowed by Board of Regents' policy at that time. The prior audit recommendation to amend the Board of Regents' policy was implemented, but OCHE inappropriately continues to use university Designated Subfunds as described beginning on page seven.

Findings & Recommendations

Federal Indirect Cost Recoveries

The Office of the Commissioner of Higher Education (OCHE) has two federal awards for which it receives indirect cost recoveries from the federal government: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) and Talent Search. The goal of GEAR UP is to encourage low-income youth to set high academic expectations, to stay in school, and to take courses that prepare them for college level study. The Talent Search program offers services to ensure students complete high school and successfully enter college or a vocational school.

The following two sections discuss instances in which OCHE can improve their accounting for federal indirect cost recoveries.

Accounting For Federal Indirect Cost Recoveries

Indirect costs recovered for the GEAR UP federal award are not deposited in the General Fund as required by state law.

Section 17-1-102, MCA, requires state agencies to input all necessary transactions to the state's accounting system by the end of each fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles. Section 17-1-106, MCA, requires agency indirect cost recoveries, other than those received by a unit of the university system, be deposited in the fund from which the indirect costs were originally paid. Further, state accounting policy defines indirect costs to include both the overhead costs originating in a state agency performing a grant and the costs of central government services distributed through the Statewide Cost Allocation Plan and not otherwise treated as direct costs.

During the audit period, OCHE drew federal indirect cost recoveries for the GEAR UP and Talent Search programs at the 8% limit for the federal awards. OCHE recorded indirect costs received for the Talent Search award as Federal Indirect Cost Recoveries revenue in the General Fund. In contrast, OCHE recorded the indirect costs

received for GEAR UP as Federal revenue in the Federal Special Revenue Fund.

The indirect costs for overhead related to the Talent Search and GEAR UP awards are paid by the General Fund. As such, the federal indirect costs recovered for both awards should be deposited in accordance with state law to the credit of the General Fund. By recording federal indirect cost recoveries for GEAR UP in the Federal Special Revenue Fund, OCHE did not match the revenues with expenses as required by generally accepted accounting principles and state law. We estimate the loss to the General Fund for the GEAR UP award, including interest, is $756,060 from fiscal year 2000-01 through fiscal year 2004-05.

OCHE staff indicated the GEAR UP indirect costs were used to operate the Academic Initiatives Program (AIP), a non-federal program OCHE accounted for in the Federal Special Revenue Fund. The AIP advocates additional admissions examinations for acceptance into undergraduate programs. During the fiscal year, OCHE records AIP expenditures as personnel services and operating expenses on the state's accounting records. At the end of each fiscal year, OCHE reclassifies these direct AIP expenditures as indirect expenditures of the GEAR UP award. As a result, all AIP expenditure activity is presented as Other Expenses on the Schedule of Total Expenditures & Transfers-Out.

Excess federal indirect cost recoveries for GEAR UP, if any, are transferred to the Designated Subfund at Montana State University-Bozeman at the end of each fiscal year. OCHE believes it has authority for its treatment of federal indirect cost recoveries because section 17-1-106, MCA, excepts units of the university system from the indirect cost requirements described above and section 20-25-427, MCA, directs reimbursement for indirect costs associated with a grant to or contract with the Montana university system or any of its units to be allocated to the Designated Subfund, as provided for in the treasury fund structure. However, as described in the next section, the Designated Subfund is not a treasury fund in

which OCHE can record financial activity. In addition, section 20-25-201, MCA, identifies Montana university system units for purposes of the indirect cost exception. This section does not identify OCHE as a Montana university system unit. Therefore, the indirect cost recovery exception for university units in section 17-1-106, MCA, does not apply to OCHE.

Recommendation #1
We recommend the commissioner's office:

A. Record indirect costs recovered from the federal awards to the appropriate fund and account, in accordance with state law.

B. Reimburse the state's General Fund for the $756,060 in indirect cost recoveries improperly recorded to the Federal Special Revenue Fund.

Transfers of Excess Indirect Costs

OCHE improperly transferred excess indirect cost recoveries into a university Designated Subfund.

In fiscal year 2000-01, GEAR UP was a new federal award to OCHE. As indicated in the section above, OCHE operated the AIP with federal indirect cost recoveries received from the GEAR UP grant. During fiscal year 2000-01, OCHE received more in federal indirect cost recoveries than they had expenditures for the AIP. The excess indirect cost recoveries were transferred to Montana State University-Bozeman's (MSU) Designated Subfund. At the end of each subsequent fiscal year, OCHE evaluated the expenditures of the AIP. When federal indirect cost recoveries exceeded expenditures of the AIP, the balance was transferred to MSU's Designated Subfund. When expenditures of the AIP exceeded federal indirect cost recoveries for the fiscal year, OCHE requested and received funds from MSU's Designated Subfund.

Section 17-2-102, MCA, establishes the treasury fund structure for the state of Montana. OCHE financial activities are appropriately

recorded in the governmental funds portion of the treasury fund structure. The Designated Subfund is part of the higher education funds portion of the treasury fund structure. Therefore, OCHE should not record its financial activity in the Designated Subfund at MSU. As described in the previous section, GEAR UP federal indirect cost recoveries should have been credited to the General Fund. As such, the current balance in the MSU Designated Subfund related to GEAR UP federal indirect cost recoveries of $117,088 must be returned to the General Fund. The $117,088 is a portion of the $756,060 owed to the General Fund, as described in the previous section.

In the prior audit, we reported OCHE had transferred unspent funds to a university Designated Subfund to be used for future retirement costs of OCHE, as was allowed by Board of Regents' policy in place at the time. The Board of Regents' policy regarding Retirement Cost Revolving Accounts has been revised to comply with state law. Another Board of Regents' policy regarding Reserve Revolving Accounts only applies to the campuses of the Montana University System. OCHE's use of Designated Subfunds at the university units is not in compliance with state law or the Board of Regents' policies.

Recommendation #2
We recommend the commissioner's office cease recording financial activity in university Designated Subfunds.

Independent Auditor's Report & Office Financial Schedules

OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Agency Fund
FUND BALANCE: July 1, 2004	$ (161,802)	$ (303,884)	$ 11,063,209	$ 11,282,469	
PROPERTY HELD IN TRUST: July 1, 2004					$ 0
ADDITIONS					
Budgeted Revenues & Transfers-In	950,946	264,846	37,801,066	53,480,213	
NonBudgeted Revenues & Transfers-In	621	66,121		36	
Prior Year Revenues & Transfers-In Adjustments	(27,440)		130,636	1,253,260	
Direct Entries to Fund Balance	136,012,225	14,791,446	19,072	(41,043)	
Additions to Property Held in Trust					1,966
Total Additions	136,936,352	15,122,413	37,950,774	54,692,466	1,966
REDUCTIONS					
Budgeted Expenditures & Transfers-Out	137,304,795	13,995,258	35,817,231	46,755,859	
NonBudgeted Expenditures & Transfers-Out	(7,771)	22,379		9,266	
Prior Year Expenditures & Transfers-Out Adjustments	7,591	13,426	(155)	1,742	
Reductions in Property Held in Trust					1,966
Total Reductions	137,304,615	14,031,063	35,817,076	46,766,867	1,966
FUND BALANCE: June 30, 2005	$ (530,065)	$ 787,466	$ 13,196,907	$ 19,208,068	
PROPERTY HELD IN TRUST: June 30, 2005					$ 0

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Agency Fund
FUND BALANCE: July 1, 2003	$ (53,123)		$ 9,433,973	$ 192,497	$ 7,910,009	
PROPERTY HELD IN TRUST: JULY 1, 2003						$ 0
ADDITIONS						
Budgeted Revenues & Transfers-In	1,018,321	209,093	36,444,349	46,227,019		
NonBudgeted Revenues & Transfers-In	80	182,861				
Prior Year Revenues & Transfers-In Adjustments	(12,139)			(195,229)		
Direct Entries to Fund Balance	139,955,049	13,305,240	2,667,023	7,934,000	(7,910,009)	
Additions to Property Held in Trust						639
Total Additions	140,961,311	13,697,194	39,111,372	53,965,790	(7,910,009)	639
REDUCTIONS						
Budgeted Expenditures & Transfers-Out	141,062,103	13,858,134	37,489,049	42,844,439		
NonBudgeted Expenditures & Transfers-Out	7,771	63,194		83,648		
Prior Year Expenditures & Transfers-Out Adjustments	116	(3,500)	(6,913)	(52,269)		
Reductions in Property Held in Trust						639
Total Reductions	141,069,990	13,917,828	37,482,136	42,875,818	0	639
FUND BALANCE: June 30, 2004	$ (161,802)	$ (303,884)	$ 11,063,209	$ 11,282,469	$ 0	
PROPERTY HELD IN TRUST: JUNE 30,2004						$ 0

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS						
Taxes	$ 876,863	$ 18,792	$ 748	$ 104		$ 896,507
Charges for Services		252,496	26,310,173	2,916,509		29,473,178
Investment Earnings		12,350	258,105	479,309		749,764
Contributions and Premiums				51,074,281		51,074,281
Miscellaneous				263,306		263,306
Grants, Contracts, Donations and Abandonments		47,329				47,329
Other Financing Sources			947,799			947,799
Federal			10,414,877			10,414,877
Federal Indirect Cost Recoveries	47,264					47,264
Total Revenues & Transfers-In	924,127	330,967	37,931,702	54,733,509	$ 0	93,920,305
Less: Nonbudgeted Revenues & Transfers-In	621	66,121		36		66,778
Prior Year Revenues & Transfers-In Adjustments	(27,440)		130,636	1,253,260		1,356,456
Actual Budgeted Revenues & Transfers-In	950,946	264,846	37,801,066	53,480,213	0	92,497,071
Estimated Revenues & Transfers-In	956,436	164,248	52,137,906	57,408,671	55,820,115	166,487,376
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (5,490)	$ 100,598	$ (14,336,840)	$ (3,928,458)	$ (55,820,115)	$ (73,990,305)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS						
Taxes	$ (14,930)					$ (14,930)
Charges for Services		$ 106,248	$ (14,825,810)	$ (3,491)		(14,723,053)
Investment Earnings		(5,650)	39,105	9,309	$ (250,000)	(207,236)
Contributions and Premiums				(4,047,292)	(55,334,202)	(59,381,494)
Miscellaneous				113,016	(235,913)	(122,897)
Other Financing Sources			361,800			361,800
Federal			88,065			88,065
Federal Indirect Cost Recoveries	9,440					9,440
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (5,490)	$ 100,598	$ (14,336,840)	$ (3,928,458)	$ (55,820,115)	$ (73,990,305)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS							
Taxes	$ 955,849						955,849
Charges for Services	80	$ 202,824	$ 26,036,290				26,239,194
Investment Earnings		6,269	148,404	$ 136,845			291,518
Contributions and Premiums				45,488,521			45,488,521
Miscellaneous				406,424			406,424
Grants, Contracts, Donations and Abandonments		63,255					63,255
Other Financing Sources		119,606	619,751				739,357
Federal			9,639,904				9,639,904
Federal Indirect Cost Recoveries	50,333						50,333
Total Revenues & Transfers-In	1,006,262	391,954	36,444,349	46,031,790	$ 0	$ 0	83,874,355
Less: Nonbudgeted Revenues & Transfers-In	80	182,861					182,941
Prior Year Revenues & Transfers-In Adjustments	(12,139)			(195,229)			(207,368)
Actual Budgeted Revenues & Transfers-In	1,018,321	209,093	36,444,349	46,227,019	0	0	83,898,782
Estimated Revenues & Transfers-In	956,436	119,412	49,532,065	56,519,150	48,129,159	50,000	155,306,222
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 61,885	$ 89,681	$ (13,087,716)	$ (10,292,131)	$ (48,129,159)	$ (50,000)	$ (71,407,440)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS							
Taxes	$ 49,376						49,376
Charges for Services		$ 101,412	$ (11,693,298)				(11,591,886)
Investment Earnings		(11,731)	(73,007)	$ (363,155)	$ (250,000)	$ (50,000)	(747,893)
Contributions and Premiums				(10,185,400)	(47,643,246)		(57,828,646)
Miscellaneous				256,424	(235,913)		20,511
Other Financing Sources			(455,249)				(455,249)
Federal			(866,162)				(866,162)
Federal Indirect Cost Recoveries	12,509						12,509
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 61,885	$ 89,681	$ (13,087,716)	$ (10,292,131)	$ (48,129,159)	$ (50,000)	$ (71,407,440)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	ADMINISTRATION PROGRAM	AGENCY FUNDS	APPROPRIATION DISTRIBUTION	BOARD OF REGENTS-ADMIN	COMMUNITY COLLEGE ASSISTANCE	GUARANTEED STUDENT LOAN PROGRAM	IMPROVING TEACHER QUALITY	MUS GROUP INSURANCE PROGRAM	MUS WORKERS COMPENSATION PROGRAM	STUDENT ASSISTANCE PROGRAM	TALENT SEARCH	TRIBAL COLLEGE ASSISTANCE PROGRAM	WORK FORCE DEVELOPMENT PROGRAM	Total
Personal Services														
Salaries	$ 1,066,567					$ 1,508,351	$ 11,099	$ 126,669		$ 15,443	$ 667,505		$ 188,915	$ 3,584,549
Hourly Wages				$ 150										150
Other Compensation				6,100						1,500				7,600
Employee Benefits	240,349					498,248	1,780	30,285		1,709	224,323		51,379	1,048,073
Personal Services-Other								2,337						2,337
Total	1,306,916			6,250		2,006,599	12,879	159,291		18,652	891,828		240,294	4,642,709
Operating Expenses														
Other Services	537,498	$ 2,566	$ 34,053	6,574		2,074,927		2,844,846	$ 395,962		86,832		89,408	6,072,666
Supplies & Materials	50,986	3,892	1,087	15,531		95,888	25	20,775			36,100		11,163	235,447
Communications	40,669			303		194,374	341	2,687		450	16,102		8,828	263,754
Travel	33,373		2,486	23,337		134,243	1,092	3,166			128,063		31,423	357,183
Rent	113,346	471				161,290		3,306			2,347		199	280,959
Utilities	16,400					23,128								39,528
Repair & Maintenance	8,207					7,543		396			272			16,418
Other Expenses	60,573			680		805,049	375	385,457	23,519		330,366		43,405	1,649,424
Total	861,052	6,929	37,626	46,425		3,496,442	1,833	3,260,633	419,481	450	600,082		184,426	8,915,379
Equipment & Intangible Assets														
Equipment						22,355								22,355
Total						22,355								22,355
Local Assistance														
From State Sources					$ 6,367,364					105,000				6,472,364
Total					6,367,364					105,000				6,472,364
Grants														
From State Sources										8,677,094		96,500		8,773,594
From Federal Sources							539,555				662,211		2,798,772	4,000,538
From Other Sources										227,902				227,902
Total							539,555			8,904,996	662,211	96,500	2,798,772	13,002,034
Benefits & Claims														
To Individuals									2,372,289					2,372,289
Insurance Payments						19,943,983		40,490,599						60,434,582
Total						19,943,983		40,490,599	2,372,289					62,806,871
Transfers														
Accounting Entity Transfers						32,800					915,000		3,403,589	4,351,389
Intra-Entity Expense			133,648,875											133,648,875
Total			133,648,875			32,800					915,000		3,403,589	138,000,264
Debt Service														
Bonds									57,645					57,645
Total									57,645					57,645
Total Expenditures & Transfers-Out	$ 2,167,968	$ 6,929	$ 133,686,501	$ 52,675	$ 6,367,364	$ 25,502,179	$ 554,267	$ 43,910,523	$ 2,849,415	$ 9,029,098	$ 3,069,121	$ 96,500	$ 6,627,081	$ 233,919,621
EXPENDITURES & TRANSFERS-OUT BY FUND														
General Fund	$ 2,138,774		$ 119,912,534	$ 52,675	$ 6,367,364					$ 8,556,321	$ 90,356	$ 96,500	$ 90,091	$ 137,304,615
State Special Revenue Fund	29,194		13,773,967							227,902				14,031,063
Federal Special Revenue Fund						$ 25,502,179	$ 554,267			244,875	2,978,765		6,536,990	35,817,076
Enterprise Fund		$ 6,929						$ 43,910,523	$ 2,849,415					46,766,867
Total Expenditures & Transfers-Out	2,167,968	6,929	133,686,501	52,675	6,367,364	25,502,179	554,267	43,910,523	2,849,415	9,029,098	3,069,121	96,500	6,627,081	233,919,621
Less: Nonbudgeted Expenditures & Transfers-Out	7,997	6,929	6,611					2,337						23,874
Prior Year Expenditures & Transfers-Out Adjustments	13,426				7,591			1,742			(155)			22,604
Actual Budgeted Expenditures & Transfers-Out	2,146,545	0	133,679,890	52,675	6,359,773	25,502,179	554,267	43,906,444	2,849,415	9,029,098	3,069,276	96,500	6,627,081	233,873,143
Budget Authority	2,280,646		133,679,892	55,424	6,359,773	42,570,098	992,050	59,544,430	2,955,000	9,063,587	3,748,727	96,500	7,971,139	269,317,266
Unspent Budget Authority	$ 134,101	$ 0	$ 2	$ 2,749	$ 0	$ 17,067,919	$ 437,783	$ 15,637,986	$ 105,585	$ 34,489	$ 679,451	$ 0	$ 1,344,058	$ 35,444,123
UNSPENT BUDGET AUTHORITY BY FUND														
General Fund	$ 134,101		$ 2	$ 2,749						$ 1	$ 566		$ 87	$ 137,506
State Special Revenue Fund										33,590				33,590
Federal Special Revenue Fund						$ 17,067,919	$ 437,783			898	678,885		1,343,971	19,529,456
Enterprise Fund		$			$			$ 15,637,986	$ 105,585			$		15,743,571
Unspent Budget Authority	$ 134,101	$ 0	$ 2	$ 2,749	$ 0	$ 17,067,919	$ 437,783	$ 15,637,986	$ 105,585	$ 34,489	$ 679,451	$ 0	$ 1,344,058	$ 35,144,123

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	ADMINISTRATION PROGRAM	AGENCY FUNDS	APPROPRIATION DISTRIBUTION	BOARD OF REGENTS-ADMIN	COMMUNITY COLLEGE ASSISTANCE	EISENHOWER MATH & SCIENCE EDUCATION ACT	GUARANTEED STUDENT LOAN PROGRAM	MUS GROUP INSURANCE PROGRAM	STUDENT ASSISTANCE PROGRAM	TALENT SEARCH	TRIBAL COLLEGE ASSISTANCE PROGRAM	WORK FORCE DEVELOPMENT PROGRAM	TOTAL
Personal Services													
Salaries	$ 1,016,891					$ 15,159	$ 1,464,686	$ 121,277		$ 681,285		$ 192,190	$ 3,491,488
Other Compensation	(50)			$ 7,200									7,150
Employee Benefits	264,136					2,303	466,482	33,403		208,156		51,673	1,026,153
Personal Services-Other		$ (9)						1,861					1,852
Total	1,280,977	(9)		7,200		17,462	1,931,168	156,541		889,441		243,863	4,526,643
Operating Expenses													
Other Services	146,941	5,088	$ 43,983	129			1,661,634	2,667,224		80,396		22,122	4,627,517
Supplies & Materials	7,849	5,390		1,149			299,356	2,472		55,277		21,376	392,869
Communications	26,908			718			194,011	1,949		15,516		4,162	243,264
Travel	30,410			22,635			107,245	1,749		108,478		33,968	304,485
Rent	108,742	1,131		585			167,336	2,466		525		293	281,078
Utilities	16,820						25,367						42,187
Repair & Maintenance	18,492						10,076	478		444			29,490
Other Expenses	47,365			2,070			648,102	362,017		352,544		19,625	1,431,723
Total	403,527	11,609	43,983	27,286			3,113,127	3,038,355		613,180		101,546	7,352,613
Equipment & Intangible Assets													
Intangible Assets	12,341												12,341
Total	12,341												12,341
Local Assistance													
From State Sources					$ 6,742,939				$ 103,000				6,845,939
Total					6,742,939				103,000				6,845,939
Grants													
From State Sources									8,744,609				8,744,609
From Federal Sources						353,521				937,534		2,294,926	3,585,981
From Other Sources									221,128				221,128
Total						353,521			8,965,737	937,534		2,294,926	12,551,718
Benefits & Claims													
Insurance Payments							19,921,785	39,669,322					59,591,107
Total							19,921,785	39,669,322					59,591,107
Transfers													
Accounting Entity Transfers							72,550			547,201		3,540,127	4,159,878
Intra-Entity Expense			140,300,381										140,300,381
Total			140,300,381				72,550			547,201		3,540,127	144,460,259
Debt Service													
Loans	5,152												5,152
Total	5,152												5,152
Total Expenditures & Transfers-Out	$ 1,701,997	$ 11,600	$ 140,344,364	$ 34,486	$ 6,742,939	$ 370,983	$ 25,038,630	$ 42,864,218	$ 9,068,737	$ 2,987,356	$ 0	$ 6,180,462	$ 235,345,772
EXPENDITURES & TRANSFERS-OUT BY FUND													
General Fund	$ 1,638,804		$ 124,480,858	$ 34,486	$ 6,292,939				$ 8,451,220	$ 81,592		$ 90,091	$ 141,069,990
State Special Revenue Fund	63,193		13,633,506						221,129				13,917,828
Federal Special Revenue Fund			2,230,000		450,000	$ 370,983	$ 25,038,630		396,388	2,905,764		6,090,371	37,482,136
Enterprise Fund		$ 11,600						$ 42,864,218					42,875,818
Total Expenditures & Transfers-Out	1,701,997	11,600	140,344,364	34,486	6,742,939	370,983	25,038,630	42,864,218	9,068,737	2,987,356	0	6,180,462	235,345,772
Less: Nonbudgeted Expenditures & Transfers-Out	70,964	11,319						72,329					154,612
Prior Year Expenditures & Transfers-Out Adjustments	116	281						(52,550)	(3,500)	(2,708)		(4,205)	(62,566)
Actual Budgeted Expenditures & Transfers-Out	1,630,917	0	140,344,364	34,486	6,742,939	370,983	25,038,630	42,844,439	9,072,237	2,990,064	0	6,184,667	235,253,726
Budget Authority	1,654,737		141,248,680	51,889	6,752,234	850,656	32,280,050	51,339,370	9,315,760	4,114,995	96,500	6,984,011	254,688,882
Unspent Budget Authority	$ 23,820	$ 0	$ 904,316	$ 17,403	$ 9,295	$ 479,673	$ 7,241,420	$ 8,494,931	$ 243,523	$ 1,124,931	$ 96,500	$ 799,344	$ 19,435,156
UNSPENT BUDGET AUTHORITY BY FUND													
General Fund	$ 23,820		$ 904,316	$ 17,403	$ 9,295				$ 186,659	$ 1,547	$ 96,500		$ 1,239,540
State Special Revenue Fund									36,864				36,864
Federal Special Revenue Fund						$ 479,673	$ 7,241,420		20,000	1,123,384		$ 799,344	9,663,821
Enterprise Fund								$ 8,494,931					8,494,931
Unspent Budget Authority	$ 23,820	$ 0	$ 904,316	$ 17,403	$ 9,295	$ 479,673	$ 7,241,420	$ 8,494,931	$ 243,523	$ 1,124,931	$ 96,500	$ 799,344	$ 19,435,156

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Office of the Commissioner of Higher Education for each of the fiscal years ended June 30, 2005, and 2004. The information contained in these financial schedules is the responsibility of the office management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the office's assets, liabilities, and cash flows.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Office of the Commissioner of Higher Education for each of the fiscal years ended June 30, 2005, and 2004, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ James Gillett
James Gillett, CPA
Deputy Legislative Auditor

October 17, 2005

Room 160, State Capitol Building, PO Box 201705, Helena MT 59620-1705
Phone (406) 444-3122 FAX (406) 444-9784 E-Mail lad@mt.gov

Office of the Commissioner of Higher Education
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2005

1. Summary of Significant Accounting Policies

Basis of Accounting

The Office of the Commissioner of Higher Education (OCHE) uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category. In applying the modified accrual basis, OCHE records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when it incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires OCHE to record the cost of employees' annual leave and sick leave when used or paid.

OCHE uses accrual basis accounting for its Proprietary and Fiduciary fund categories. Under the accrual basis, as defined by state accounting policy, OCHE records revenues in the accounting period earned when measurable and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though OCHE receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

Notes to the Financial Schedules

OCHE accounts are organized in funds according to state law applicable at the time transactions were recorded. OCHE uses the following funds:

Governmental Fund Category

General Fund - to account for all financial resources except those required to be accounted for in another fund. OCHE includes funds appropriated for general operations of the office and distributions to the university units and tribal and community colleges for their general operations.

State Special Revenue Fund - to account for proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. The majority of this activity includes mill levy distributions to the university units.

Federal Special Revenue Fund - to account for funds received from federal sources that are used for the operations of the office. These include the Federal Family Education Loan Program (FFELP), the Vocational Education – Basic Grants to States (formerly Carl D. Perkins) grant, the Talent Search grant, and the Gaining Early Awareness and Readiness for Undergraduate Program (GEAR UP) award.

Proprietary Fund Category

Internal Service Fund - to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. Prior to fiscal year 2003-04, OCHE accounted for the Montana University System's (MUS) group health insurance and flex spending in this fund. See note 5.

Enterprise Fund - to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that OCHE finance or recover costs primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. OCHE

Enterprise Funds include the MUS Group Insurance Program, the MUS Workers' Compensation Program, Montana State Fund Scholarships, and the Wellness Program.

Fiduciary Fund Category

Agency Fund - to account for resources held by the state in a custodial capacity. OCHE agency funds include college license plates, optional retirement funds, and Guaranteed Student Loan collections.

2. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. Each agency has authority to pay obligations from the statewide General Fund within its appropriation limits. Each agency expends cash or other assets from the statewide fund when it pays General Fund obligations. OCHE's outstanding liabilities exceed the assets OCHE has placed in the fund, resulting in negative ending General Fund balances for each of the two fiscal years ended June 30, 2005, and June 30, 2004. These balances reflect the activity at the OCHE and not the fund balance of the statewide General Fund.

3. Direct Entries to Fund Balance

House Bill 2, Chapter 612, Laws of 2003, appropriated General Fund monies to the OCHE for distribution to the units of the university system, the community colleges, and the tribal community colleges. OCHE accounts for this activity in the General Fund as Direct Entries to Fund Balance on the Schedule of Changes in Fund Balances & Property Held in Trust, and Accounting Entity Transfers to university in the Appropriations Distribution Program, Local Assistance from State Sources to community colleges in the Community College Assistance Program, and Grants from State Sources to tribal colleges in the Tribal College Assistance Program on the Schedule of Total Expenditures & Transfers-Out.

Section 20-25-423, MCA, levies property taxes to support, maintain, and improve the MUS. The state treasurer collects university property tax revenue and records it in the State Special Revenue Fund of the Department of Revenue. These collections appear on the Schedule of Changes in Fund Balances & Property Held in Trust as

Direct Entries to Fund Balance in the State Special Revenue Fund totaling $14,791,446 and $13,305,240 in fiscal years 2004-05 and 2003-04, respectively.

4. Work Force Development Program

OCHE recorded expenditures of the Vocational Education – Basic Grants to States of $5,741,153 and $5,523,901 in fiscal years 2004-05 and 2003-04, respectively. OCHE contracted with the Office of Public Instruction (OPI) to manage the portion of these funds provided to secondary schools and transferred $3,043,589 and $3,540,127, respectively, to OPI for this purpose.

5. MUS Group Insurance Program

Prior to fiscal year 2003-04, OCHE accounted for the MUS group insurance program in the state's Internal Service Fund. In fiscal year 2003-04, OCHE began accounting for the MUS group insurance program in the Enterprise Fund, in accordance with Governmental Accounting Standards Board (GASB) Statement 34. GASB Statement 34 requires such programs to be accounted for in the Enterprise Fund. Prior to making this change, OCHE budgeted for the program's activity in the Internal Service Fund, as shown on the Schedules of Total Revenues & Transfers-In.

6. MUS Workers' Compensation Program

The Board of Regents elected to provide workers' compensation coverage under Compensation Plan Number One, authorized by section 39-71-2101, MCA, as of July 1, 2003. Prior to that date, the MUS obtained its workers' compensation coverage through participation in the Montana State Fund. The MUS Workers' Compensation Program (program) was audited by other auditors for fiscal year 2004-05 and fiscal year 2003-04 (05C-06).

In fiscal year 2003-04, the program's financial activity was not accounted for on the state's accounting system. In fiscal year 2003-04, total program revenue for premiums was $2,424,455 and operating expenditures were $2,489,132.

7. Related Party Transactions

OCHE's Montana Guaranteed Student Loan Program (MGSLP) guarantees loans owned by the Montana Higher Education Student Assistance Corporation (MHESAC). The Board of Regents of

Higher Education and MHESAC have four common board members. OCHE and MHESAC both had lease agreements with Lewis and Clark County for the building in which they were located in fiscal years 2004-05 and 2003-04. OCHE had an agreement with MHESAC to share certain costs associated with the building.

MGSLP also has an agreement with Student Assistance Foundation (SAF) for the lease of computer equipment and the supplies and personal services related to the computer system. OCHE paid SAF $494,722 and $495,739 in fiscal years 2004-05 and 2003-04, respectively.

MGSLP receives certain services, such as mail processing, from state agencies that directly benefit SAF. SAF reimbursed OCHE $28,393 and $146,141 in fiscal years 2004-05 and 2003-04, respectively, for those services. The drop in reimbursements in fiscal year 2004-05 is attributed to SAF's decision to process their own mail. OCHE accounted for SAF's reimbursements as expenditure reductions.

Certain employees of the Montana University System provide services to the MUS Workers' Compensation Program at no charge. The value of such services has not been determined.

Office Response

MONTANA UNIVERSITY SYSTEM
Office of the Commissioner of Higher Education

46 N Last Chance Gulch ◊ PO Box 203201 ◊ Helena, Montana 59620-3201
(406)444-6570 ◊ FAX (406)444-1469

December 5, 2005

RECEIVED
DEC 0 5 2005
LEGISLATIVE AUDIT DIV.

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
State Capitol, Room 135
P.O. Box 201705
Helena MT 59620-1705

Dear Mr. Seacat:

Enclosed you will find the Office of the Commissioner of Higher Education's response to the recommendations presented in our Financial-Compliance audit for the two fiscal years ended June 30, 2005.

We appreciate the efforts made by the audit team and thank those involved for their invaluable assistance. Our office will continue the implementation of needed improvements and we remain committed to compliance with regulations and assuring accountability for the Office of the Commissioner of Higher Education.

Sincerely,

Sheila M Stearns

Sheila M. Stearns
Commissioner of Higher Education

Office of the Commissioner of Higher Education
Response to the Legislative Audit Division
Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 2005

Recommendation #1
We recommend the Commissioner's office:

A. **Record indirect costs recovered from the federal awards to the appropriate fund and account, in accordance with state law.**

B. **Reimburse the state's General Fund for the $756,060 in indirect recoveries improperly recorded to the Federal Special Revenue Fund.**

The Office of the Commissioner of Higher Education concurs with the recommendation. We would like to note that the Office of the Commissioner of Higher Education (OCHE) did consult with legal counsel at the time that it directed the indirect costs through a designated subfund to fund academic quality initiatives, and believed we were using the funds wisely and properly. However, as noted above, we concur that the state law was ambiguous and we are already following the direction noted in recommendation #1. It is also important to note that OCHE implemented an indirect cost recovery plan effective July 1, 2005 and is presently recording indirect costs from federal awards to the appropriate fund and account. As noted in the response to Recommendation #2, the remaining balance of $117,088, in the university Designated Subfund, will be transferred to the General Fund reducing the required reimbursement balance to $638,972. Within the budget of the OCHE, we will do everything possible to address the remaining balance. It is important to note that the calculated balance accumulated over a series of years and our ability to address such a balance, within our biennium budget, is clearly limited.

Recommendation #2
We recommend the Commissioner's office cease recording financial activity in university Designated Subfunds.

The Office of the Commissioner of Higher Education concurs with the recommendation. The OCHE will discontinue the transfer of funds to university Designated Subfunds and will transfer the remaining balance of $117,088, related to GEAR UP federal indirect cost recoveries, to the General Fund.